1812

1939

Economic Conditions
Governmental Finance
United States Securities

New York, December, 1939

General Business Conditions

THE influence of the outbreak of war upon business in this country has diminished further during November. Markets for the most part have been routine and orderly, and the general tendency has been to get on a normal basis again. The war started business off on a sensational rise, but the stimulus was largely psychological, and the early fears of sharp price advances and delivery difficulties have mostly subsided. The outlook for war business is still undetermined. So far this country has received few large orders from the belligerents, except for airplanes. If the war lasts long and the fighting becomes active, the demand for materials will increase; but for the near future a more important consideration is the inaction of the armies, which now seems likely to continue through the Winter. Obviously the consumption of munitions to date has not cut very far into the belligerents' supplies, or put them under pressure to rush their buying; and the demobilization of certain French army units in order to return the men to productive work is a striking demonstration that the precedents of the last war furnish little guidance, either military or economic, in the present situation.

The news in general has tended to support the conservative opinions expressed in these Letters, and in many other quarters, as to the volume of war business to be expected, at least in the near future. Foreign exchange rates have been weak against the dollar, despite continuing releases of gold by foreign countries to obtain dollars, and also moderate sales of foreign-owned American securities. The exchange weakness emphasizes the problem of paying for purchases in this country. An Associated Press dispatch of November 20, quoting officials of the British Food Ministry on plans for purchases of food abroad, said "little would be bought from the United States because the dollar-pound sterling exchange rate was disadvantageous." Licenses for import of fresh fruits into Great Britain from the United States have been suspended. Arrangements to take over the Canadian lead and zinc output, and West African cocoa, give additional evidence that Great Britain intends to buy everything possible within the Empire, and as cheaply as possible; and a subsequent article in this issue shows how much more the Empire can supply than in 1914.

Of course Great Britain and France, considered together, have large resources in the way of gold stocks, new production of gold, and holdings of American securities, all of which can be turned into dollars to pay for the goods that will have to be bought if the war is long and active. They are certain, however, to plan their expenditures carefully, and to conserve these resources to the utmost.

Exports of the United States have increased since the war broke out, both as compared with the preceding months and with a year earlier, but it is prudent to take a conservative view of the export prospect. The increase in cotton shipments, both seasonal and due to the subsidy program, is an important item in the gains. Exports to the belligerents as a group in October were much smaller than last year, while those to Canada, Latin America and the Scandinavian countries showed heavy increases. Part of the rise in neutral orders following the outbreak of the war was in anticipation of price increases or shipping difficulties, and this type of buying has now slackened to more normal volume. The excess of merchandise exports over imports in October was $117,000,000, the largest since January, 1938. This follows a balance of $107,000,000 in September. Export surpluses of this magnitude place a strain upon the means of other countries to make payments here, and their problem is all the more difficult because of the reduction of our tourist expenditures abroad.

Domestic Influences Dominate Outlook

All these elements in the situation make it plain that the trend in this country for the next few months at least will be governed chiefly by domestic influences. The outlook for that time is largely a question of home consumption, the inventory position, progress in new enter-

prise and investment, and other factors hardly connected with the war.

Moreover, business men more and more are taking the position that, irrespective of war developments, the problem of turning the upswing started by the war into a sound and lasting recovery is a domestic problem. All know by now that a war boom produces only an illusion of prosperity, and that in reality it is the antithesis of prosperity, for it represents the greatest waste, destruction, and disruption of sound economic relationships that mankind can possibly experience. This country wants more business, and more production and employment, but it wants improvement based on a sound domestic situation, which will last independent of war orders.

It was easy to misjudge the business prospect at the outbreak of war and the markets pitched their expectations too high. Fortunately, the sobering up came quickly. The beneficial effects of the change in psychology remain. Business has been given a start; the upswing which began as a forward buying movement in materials has broadened encouragingly into a revival of capital expenditures; and the problem now is to establish domestic policies that will encourage domestic enterprise and carry the recovery forward.

The alternative problem is to guard against excesses if war orders become heavy and the impetus pushes business into the boom area. Then the task will be to control the boom,—to prevent the spiralling of prices and wages, the over-investment in enterprises which could not sustain themselves in peace-time, and the other possible excesses from which a calamitous reaction would follow. At present the emphasis upon controlling the boom is still precautionary, for the boom psychology has gradually passed off. However, the danger will be present as long as the war lasts. In any case the policies that will prevent excesses, and those which will carry the business upswing ahead on a sound foundation, are in many respects identical. The needs are, first, to keep costs down, to hold prices, wages, and all the other elements in the economic system in balanced relationship, and to make sure that changes are in the direction of improving the equilibrium instead of disturbing it further; and, second, to encourage investment in projects which are expected to pay their way.

One of the strong elements in the outlook is the good sense and self-restraint shown by business leaders. From the first they have emphasized that a rise based on anticipation of war orders would solve no basic problems. Likewise, the policies of important industries have been aimed toward stopping the boom before it could become dangerous.

Steel Prices Reaffirmed

The automobile industry always has been far-sighted in its price policies, and has put on the market new models at prices which are producing the largest retail sales in three years; the tire companies have reduced prices; and now the steel industry, despite higher costs for scrap, pig iron, manganese and its other materials, has announced that its quotations for the first quarter of 1940 will be unchanged, except for a $2 advance in hot rolled sheets and strip, which have been out of line.

The steel makers have experienced the biggest demand in their history, and probably could make price advances stick. However, the policy is to run no risk of shutting off demand, and to make no contribution toward inflationary tendencies. It is true that steel is traditionally "prince or pauper," and in times of good business should make earnings which can be laid aside for bad times or used to supply the need for new capital. However, the industry profits through larger volume and greater efficiency, and as the most important basic manufacturing industry of this country it has great responsibility for the general situation. If it can keep steel moving, its men working and their pay envelopes full by foregoing the price advance, it will make a contribution of immense value toward keeping the situation stable, and set an example to other industries and to labor.

When business is running as it has been for the last three months, the temptation of various groups is to use the opportunity to get more for themselves, other than the gains that naturally come from the equitable distribution of increased production. But if the effort is at the expense of other groups it cannot possibly succeed, and the attempt is a menace because it may disrupt the exchange of goods and cause unemployment and depression, or, alternatively, result in an inflationary spiral from which a collapse is inevitable.

These principles should have the consideration of manufacturers, of labor, and of public bodies. The dreaded inflationary spiral may start with wage increases as well as price advances, and they may equally disrupt business; for if demand is not strong enough to support higher wage costs the result will be a contraction of employment, and labor will give up in idle time and reduced weekly pay the gains apparently received through higher hourly wages. This happened in 1937, and it is in the interest of all elements to see that it does not happen in 1940. Unquestionably the strike which kept the Chrysler Corporation out of production for nearly two months, and which involved questions as to the authority of management as well as wage demands, has spread uneasiness as to the prospective labor situation.

Expectations of Slackening in Production

The prediction made in some quarters as early as September to the effect that before the end of the year industrial output might exceed all past records now seems to be on the way to fulfillment. The Federal Reserve index of industrial production (1923-25 = 100) was 120 in October, will be moderately higher for November, according to preliminary indications, and should make a further slight advance in December, after adjustment to allow for the usual seasonal drop. This points to a level possibly above the all-time peak of 125 reached in June, 1929. Compared with production before the war the increase is approximately 25 per cent. The industries still have unfilled orders that will support production at a high rate well into the first quarter on the average, and in some cases longer, although new buying has slackened.

Expectations of a slowing down in factory operations sometime during the first half of 1940 are general. It would be expecting a great deal to look for consumption to rise sufficiently to take all this output promptly off the markets. The chief question is whether the reaction will be moderate or severe. The inventory situation is the center of inquiry, and the inadequacy of current inventory information is an old story. However, the evidence indicates that so far there has been more shifting of inventories from producers along to positions closer to the consumer than there has been aggregate fresh accumulation. Production and shipments of steel have increased 50 per cent in three months, but a survey by the magazine "Steel" shows that consumers' inventories are up only 12 per cent; and the opinion in the industry is that the excess of steel output over final consumption is represented largely by the necessary increase of steel in process, in plants whose finished product in turn is sold ahead. This situation is not unhealthy, and will not be until finished stocks accumulate, which, to be sure, they may do later.

In foods and consumer merchandise generally the first development was the shift of goods from the manufacturer into distributing channels. The danger point in these lines will be when "double" inventories exist, in the hands of both manufacturers and distributors; and this point also has hardly been reached. The commitments of both department stores and large chain organizations have not been over-extended, according to most observers, and general indications are that consumption of merchandise is running closer to production than was the case in 1937. All this points to a moderate rather than a severe reaction, at least so far as the first quarter is concerned, and another factor is that buyers who have replenished their inventories seem inclined to keep them up and to maintain a greater forward coverage, a reasonable policy while the war lasts.

Heavy Capital Goods Orders

Irrespective of the inventory position, business in the first quarter will have the support of a high level of operations in the capital goods industries. This is probably the most important element in the outlook. The orders taken by these industries since the outbreak of war in many cases have exceeded the best figures of the past eight or nine years. Airplane manufacturers are estimated to have unfilled orders in excess of half a billion dollars, and are expanding plants to care for them. Ship yards had 1,156,150 tons of seagoing vessels under construction at the beginning of November, which is far greater than at any time since 1920 and within striking distance of the peak then. Both these industries will be at capacity as long as the war lasts.

Many machine tool manufacturers cannot promise deliveries before the second half of next year, and general machinery makers are well sold. Railway equipment orders placed have been approximately equal to 1936, which was the best year since 1929. Farm equipment orders continue good and production will be active during the next few months. Sales of electrical equipment have reached high figures and new installations by the electric light and power companies in 1940 seem certain to be well ahead of 1937 and the largest in ten years. Moreover, plans are being made more confidently for installations two or three years ahead.

Finally, building contract awards are well maintained. October showed some slackening, but the figures for the first half of November were exceptionally large, with gains in all classifications. The F. W. Dodge Corporation, which gathers the contract figures, estimates that 1940 will show another increase in construction, for the seventh consecutive year. This authority looks for public building to hold up despite the virtual completion of the 1939 P.W.A. program, which it believes will be offset by highway and subsidized public housing construction. It looks for an increase of 14 per cent in residential construction of all types; for gains in commercial and manufacturing building, which, however, remain at comparatively small totals; for an increase in total private building of 11 per cent; and a gain in construction of all kinds of 7 per cent.

These advances in capital goods are the natural result of the rise in business activity since September. Whatever their feeling about the future, some concerns are compelled to go ahead with new programs or with modernization and replacement to meet the present demands. New orders for capital goods have

slackened a little during November, and it remains to be seen how freely they will be resumed. One requirement necessary to keep them going will be an increase in the volume of new capital issues, and the renewed firmness of the bond market is a hopeful indication.

It would be an unusual experience, if not a virtual impossibility, to have a major business recession with capital goods industries as active as is now indicated for the first quarter. Thereafter the situation will depend upon a resumption of new orders above recent levels, and that in turn upon the reopening of the capital markets, the general conditions affecting domestic enterprise, and war business.

Money and Banking

In money and banking, the principal feature continues to be the impressive action of the bond market. During November prices of United States Government and other high grade bonds advanced into new ground since the outbreak of war, and in the case of certain best grade corporate obligations reached levels close to pre-war. Indicative of the trend, Moody's price index of Treasury bonds maturing or callable after 10 years stood at the close of the month about 3 points from the all-time high and about 6 points above the war panic low. At the same time the index of triple A corporates rose to within 2 points of the peak and nearly 8 points above the low.

The following table of Moody's bond averages affords a basis for comparing current bond prices with high and low levels for this year and earlier years:

High Grade Bond Prices*

		U. S. Gov'ts	Rails	Public Utilities	Industrials
Nov. 28, 1939....		114.83	110.63	123.33	127.83
1939...............	H	117.72	112.25	124.48	132.30
	L	108.72	106.54	114.93	116.21
1938...............	H	112.81	109.24	121.94	127.34
	L	109.58	99.83	116.43	119.25
1937...............	H	112.78	113.48	118.60	122.86
	L	107.01	105.79	111.43	112.25
1936...............	H	112.81	113.27	118.38	122.17
	L	107.77	105.41	112.86	114.51
1935...............	H	109.20	105.60	112.86	115.14
	L	105.66	103.20	104.67	102.30

*Source: Moody's Investors Service. U. S. Government prices are averages of eight issues due or callable after ten years. Corporate AAA bond indexes are computed on basis of 4% 30 year issue.

Reflecting the improvement in outstanding bonds, appetite for new issues likewise increased, enabling the Treasury to dispose of $500,000,000 of new 9-11 year 2 per cent bonds for cash, the first direct cash offering other than bills by the Treasury in a year. The offering was heavily over-subscribed and immediately rose to a substantial premium. Including the latest operation, the refinancing in October of over $700,000,000 of Commodity Credit and Treasury notes, and the raising early in November of $250,000,000 of money for the Reconstruction Finance Corporation, the Treasury has successfully carried through nearly $1,500,000,000 of direct and agency financing within the past two months—a good showing under any conditions, but especially so considering the war-time uncertainties.

In the corporate issue market, the signal success that attended the offering of $52,500,000 bonds and debentures of the Public Service Co. of Colorado was looked upon as a forerunner of substantially increased activity in coming weeks.

Underlying Money Conditions Strong

Underlying money conditions continue strong, with excess reserves of member banks on November 22 reported at $5,170,000,000. While this is a reduction from the record high of $5,530,000,000 on October 25, it is still so large that fluctuations of a few hundred millions one way or the other have little significance. During the past month the position of bank reserves has been affected by the building up of Treasury balances in the Reserve Banks resulting from the sale of R. F. C. notes, by the seasonal currency expansion customary at this time of year, and by the policy of the Reserve Banks of reducing their portfolios of Government securities.

The decline in the Federal Reserve holdings of Governments marks a reversal of the policy in September when the Reserve Banks intervened to support the market in the face of selling induced by the outbreak of war. At that time the central banks increased their holdings of Government issues by approximately $400,000,000, while simultaneously shifting something over $60,000,000 of Treasury bills into bonds and notes. As bond prices have rallied since September the Reserve Banks have been following the logical course of lightening their holdings, thus tending to mop up some of the surplus credit put out during the emergency and at the same time placing themselves in a more favorable position to render new support should occasion require. Altogether, from the September peak to November 22, the System's portfolio dropped by $233,000,000, of which $196,000,000 was in bills, $25,000,000 was in bonds and $12,000,000 in notes. That it was possible to effect this reduction in advance of a $500,000,000 cash offering by the Treasury speaks well for the character of the market.

In December, excess reserves are due for further decline, owing to holiday currency requirements, payments for new Treasury securities and income tax collections. Following the turn of the year they should again increase. The country's stock of gold continues to rise, mounting approximately $160,000,000 in the first three weeks of November to a new peak of $17,257,000,000.

New High for Member Bank Loans and Investments

Condition statements of weekly reporting member banks revealed further growth of total loans and investments and of deposits during November. In the case of loans and investments, the increase was caused principally by bank subscriptions to the Treasury's R. F. C. note offering, which, combined with gains in other assets, lifted the total to a new high level, surpassing for the first time the old peak in 1936.

In the period of nearly three months from the outbreak of war to November 22, total loans and investments gained by approximately $650,000,000, of which a little over $400,000,000 was in loans, a larger proportion than has been seen in more than two years. Bank holdings of United States Government obligations expanded $280,000,000, mainly because of increases in Treasury bills and the recent purchases of R. F. C. notes; holdings of Treasury notes were practically unchanged, and of Treasury bonds somewhat lower.

Loans to commerce, industry and agriculture were again higher in November, continuing the rise which has netted $500,000,000 since the beginning of August. "Demand deposits adjusted" increased more than $350,000,000 in the first three weeks of the month and were approximately $3,000,000,000 greater than a year ago.

Foreign Money Markets and Exchange

Abroad, the initial disturbance to money conditions caused by the war has in large measure subsided, and the markets, outwardly at least, have assumed a more normal aspect. With a falling off in currency hoarding and an increase in expenditures for mobilization and national defense, bank deposits again increased, the totals for the London Clearing Banks rising to £3,327,000,000 by the end of October, or close to the all-time high of January, 1938. In the British money market, prices of gilt-edge securities have recovered well above the official minimum levels set in August, while short-term rates have eased sharply as the Bank rate was dropped to 2 per cent from the 4 per cent level established at the outbreak of war.

The easing of the British money market is important to the program of defense borrowing, definite plans for which are still unannounced. Pending a large war loan, the British Treasury continues to finance its needs by means of Treasury bills, as a result of which the floating debt rose to a record level of £1,346,000,000 at the beginning of November, compared with £1,127,000,000 on August 19. According to a statement by Sir John Simon, Chancellor of the Exchequer, the deficit for the second half of the present fiscal year (ending March 31, 1940) will run around £25,000,000 per week.

After a considerable degree of steadiness in October, sterling and continental exchanges displayed renewed weakness early in November as fears grew of an invasion of the Low Countries by Germany. Although sterling official rates were maintained at $4.02-$4.04, the open market rate fell to $3.78, or within 3 cents of the low reached in September. Contributing to pressure on the pound at the time was the transfer by the Japanese of sterling reserves from London to New York, following the decision of the Japanese authorities to switch the yen from a sterling to a dollar basis at buying and selling rates of 23.44 and 23.47 cents respectively, thus effecting a devaluation of about 15 per cent in the yen and the yen bloc currencies. Upon the passing of these influences, the sterling market steadied and moved back to $3.94 and has since remained in that neighborhood or somewhat lower.

Dutch and Belgian currencies were especially under pressure, the belga dropping to a new low of 16.07 cents before recovering to 16.60. The guilder, which was more strongly supported, did not fall below the pegged rate of 53.08, although the forward rates moved to a substantial discount.

During the past month there has been a very pronounced widening of the discount on future sterling, which reached a maximum of 4½ cents for one month, equivalent to approximately 14 per cent per annum and was even higher for periods of less than one month. It is difficult to account for this extreme weakening of sterling futures except that the amount of spot sterling available is limited and there has been a heavy demand for it. Overdrafts in London are prohibited and London banks are prohibited from dealing in sterling futures.

French franc futures also widened with sterling, but this was a natural sequence inasmuch as the franc and pound are tied together.

New Proposals for Government Loans to Small Business

Among bills introduced in the recent special session of Congress of interest to bankers and business men generally is that sponsored by Senator James M. Mead of New York, for the establishment of a new government agency within the Federal Reserve System for the purpose of making loans to small business. As provided in the bill, the capital funds of the new agency, to be known as the Industrial Loan Corporation, would be provided by the Treasury out of the remaining profits of gold revaluation, and consist of $100,000,000 of capital and $39,000,000 of surplus. Administration would be vested in the Board of Governors of the Federal Reserve System, and operations conducted through the twelve Federal Reserve Banks and their twenty-four branches as field agencies.

The Corporation would have power to issue up to $500,000,000 of its own securities, guaranteed both as to interest and principal by the United States Government. It would take over the present business loans and business loan commitments of the Federal Reserve Banks and have authority to make new loans to, or purchase preferred stock from, business enterprises for periods up to ten years, and in amounts not exceeding $1,000,000 in case of any single enterprise, with provision for amortization sufficient to retire at least 40 per cent of such outstandings within the ten-year period. Besides its power to make direct loans, the Corporation would be authorized to utilize up to $25,000,000 of its surplus to insure bank members of the Federal Deposit Insurance Corporation against losses on loans not exceeding $25,000 to any one borrower.

In other words, what is proposed is a combination Government-direct lending and insurance plan, designed, to quote Senator Mead, "to ease the credit problems of small and intermediate-sized business concerns."

Plan an Outgrowth of the Eccles' Proposals Last Spring

In presenting his new bill, Senator Mead stated further that it was patterned after the recommendations by Chairman Eccles of the Federal Reserve Board to the Senate Banking and Currency Committee last Spring. At that time the Committee was conducting hearings on the Mead-Allen bill providing for insurance of bank loans by the Reconstruction Finance Corporation.

The new bill differs from the earlier proposal not only in general set-up and shift of jurisdiction from the R. F. C. to the Federal Reserve Board, but also in the grant of authority to make direct loans and purchase preferred stock, and in the conferring of broader discretionary powers with respect to the terms of insurance.

Moreover, in express language it definitely contemplates putting the government permanently in the lending business, which was not the case with the proposals up to this time.

Controversy as to Credit Availability Not New

As is well known, the controversy as to the need for additional capital and credit facilities for small business is one of some years standing. It developed during the early years of the depression when a feeling grew that banks, by reason of heavy losses and the uncertain conditions, had become unduly conservative in their lending policies, particularly as regards loans to the smaller enterprises. As a result of this growing agitation, Congress in 1934 gave broad powers to the Reconstruction Finance Corporation and the Federal Reserve Banks to make loans to business for as long as approximately five years (in the case of R. F. C., later extended to permit any maturities in its discretion), to provide for those cases in which the loans were refused by banks.

Notwithstanding the provision of these additional facilities, and the natural profit incentive of the commercial banks to employ their overflowing surplus funds as widely as possible consistent with reasonable safety, the feeling has persisted that credit and capital are not as freely available to business as they should be, and this feeling has found expression in legislative proposals such as those here under discussion.

The Argument as to Credit Availability—Pro and Con

It will be recognized that the question whether business is getting all the credit (or capital) to which it is entitled is extremely difficult to answer in precise terms. The lending of money is not an exact science; there are no hard and fast rules to cover all cases, and what one lender may consider a safe proposition another may not. Moreover, anything that bankers may have to say on the subject is perhaps suspect from the start, on grounds of their being interested parties.

Fortunately, there is evidence upon the subject from sources other than the bankers themselves. We have referred above to the powers granted to the Federal Reserve Banks and to the R. F. C. to make loans to borrowers who were unable to obtain accommodation from the commercial banks. Although both agencies have exercised their powers diligently and in good faith, nevertheless they had outstanding at the end of September only $140,000,000 of such loans, or less than 1 per cent of the total loans of all commercial banks in the country. As evidence of the high degree of risk in these loans, the Federal Reserve Bank of New York in its Monthly Review for August, 1938, states that a number of the concerns to which it made loans have failed, and that "in general, the experience of this bank with this type of loan indicates that the income received, even at rates as high as 6 per cent, is not adequate to cover expenses and losses."

In the hearings on the Mead-Allen bill, the arguments for extending government facilities in the field of business loans were well stated by Mr. Eccles, and may be summarized as follows:

First, that there is a substantial number of deserving concerns whose paper, either because they are new or because of present business conditions, is at the border line of bankable assets, and hence are unable to satisfy their short and intermediate credit needs at the banks, and

Second, that there is a shortage of long-term credit and capital for small business arising from various causes, including increased cost of issuing securities due to registration re-

quirements, prohibition of security affiliates of banks, prohibition of underwriting by banks, and elimination of local underwriters in various small communities.

It was Mr. Eccles' contention that the authority to make loans in alleviation of these difficulties, which had already been granted to the Federal Reserve Banks and to the R. F. C., fell short of the requirements, hence his endorsement of the purpose of the legislation then pending, though his disagreement as to method led to his alternative proposal now largely embodied in the new Mead bill.

Before the same committee of Congress quite a different point of view both as to the bill then under consideration and to the Eccles' program was presented by no less authority than the Hon. Jesse H. Jones, then Chairman of the R. F. C., but since elevated to the post of Federal Loan Administrator. Speaking of the activities of the R. F. C., Mr. Jones stated that the Corporation up to that time had approved business loans of something over $510,000,000. Continuing with a discussion of applications received, he said:

> The great majority of these inquiries and applications for business loans come from applicants with promotional ideas, with no successful record of business experience, and little prospect of success or earnings. In most cases there was no economic justification for the loan sought, and which if made would only have had the effect of aiding one business at the expense of another.

Mr. Jones went on to give figures showing the extent to which the Corporation was giving aid to small business, and repeatedly throughout his testimony emphasized in positive language his belief that the existing machinery was adequate to take care of the needs of all worthy borrowers. We quote further from his testimony, as follows:

> Much is being said about credit for little business and I call your attention to the fact that 37 per cent in number of all our business loans have been for $5,000 or less, 71 per cent for $25,000 or less, 83 per cent for $50,000 or less, and 91 per cent for $100,000 or less. Our average loan to business has been $55,000. We have never regarded a million dollar loan a small loan, and have had very few applications of this size. . . .
>
> The directors and executive force of the R.F.C. are most sympathetic to the problem of loans to distressed business. We live with it day and night, Sundays and Holidays, and could not be otherwise. Any deserving borrower, who can furnish security that will reasonably assure repayment of his loan, can have a loan, if he will apply to the R.F.C. for it, and on very generous terms, provided the loan will serve a useful purpose and is consistent with the law. . . .
>
> There is not a little-business man in the United States that is entitled to a loan, with reasonable expectation of being able to repay it, that cannot get a loan, whether it is for $500 or $5,000, if he will come and apply for it. We cannot go out and hunt him up, and look for him. Some may feel there is no use to apply. But we have tried; we have used the radio, we have done everything in the world to get them to apply. We try harder every day. We keep on, because you feel and there are other people who feel that there is a demand that is not being supplied. . . . .

Certainly these are sweeping statements; yet they appear to be fully supported by the findings of a committee of experts from another branch of the Government—the Department of Commerce. In his statement in the Senate hearings Mr. Jones said that in March of the same year he suggested to Secretary Hopkins that the latter send his representatives to examine some of the Corporation's business loan applications that had been rejected. Three experts of the Department of Commerce were appointed and upon completion of their examination submitted their report, a copy of which is included in the record of the hearings. Inasmuch as the report could hardly be more approving as to the liberality of R. F. C. lending policies, or more disparaging as to the opportunities for further incursions by government into the business lending field, a reproduction of the following paragraphs from its general conclusions seems worth while:

> The investigation of loan applications rejected by the Reconstruction Finance Corporation has revealed a few instances where, subject to further examination, unsecured or inadequately secured loans might be extended with reasonable assurance that the borrower would be really benefitted and that repayment would be made. Considered solely on their individual merits, it would perhaps be desirable to provide assistance to such applicants. Insofar as the present sampling affords a roughly accurate picture of the situation, however, it seems clear that the field for sound unsecured loans is very restricted and that the creation of facilities for this purpose would probably not result in any appreciable expansion in Government loans to business. It is also clear that the extension of unsecured loans on a reasonably sound basis would not satisfy more than a very small part of the present and potential demand for additional Government credit. The granting of "character" loans to this small part and the refusal to grant "character" loans to the great majority of applicants might well have repercussions which it would be preferable to avoid.
>
> The evidence indicates that there can be no appreciable expansion in Government loans and no satisfaction of a substantial portion of the demands for credit unless lending policies are so relaxed as to permit favorable action on a large proportion of applications which, on the basis of the present study, are unsatisfactory from more than one viewpoint. Many individual loans granted on such applications would doubtless prove to be satisfactory, but on the group as a whole heavy losses would have to be expected. The Government would be faced with the necessity of deciding whether to continue to administer aid to delinquent borrowers and accept a semipermanent interest in unprofitable enterprises or to write off its losses and dispose of such assets as might be available.

Perhaps the most interesting fact brought out at the Senate hearings was that so-called little business itself is by no means unanimous in demanding that the government expand further its facilities for this class of loans. Several of the witnesses, representative of small-business men's associations and themselves heads of business enterprises, took a position definitely opposed to such expansion. Among those so testifying was Dewitt M. Emery, President of the National Small Business Men's Association and President of the Monroe Letterhead Corporation, of Akron, Ohio, who said in part:

> In most instances, small business competes with small business. When you propose to make easy loans to the weaker among us, you are simply subsidizing the weak to remain in competition with their more successful neighbors. And it is on behalf of these

more successful small-business men that I make my appeal that no such loan system as is here proposed be introduced into our national economy.

Since then this Association has reiterated its stand in forceful language when, at its Second National Convention in Detroit on October 10, 11 and 12 of this year, it adopted the following resolution:

> We oppose use of national credit for subsidizing insolvent business. We believe that there is no demand for legitimate bank credit which our banks are not eager to meet. Adequate private funds for the capital requirements of small business and for new enterprise would be immediately available if the present tax structure were altered to permit their normal employment without penalty; if the rulings of the bank examining authorities were liberalized to permit the free exercise of experienced banking judgment.

Evidence From the Banks

In the discussion so far, we have purposely stressed evidence presented from non-banking sources, and yet it is only fair to recognize that the regular commercial banks have exerted every effort that could be thought of to find new outlets for their funds. The growth of personal loan departments, the entrance of banks into the instalment credit field and the growing practice of making term loans are all indications of the search for new ways of using money and of the attempt to adapt banking practices to the changing needs of business.

Testifying on the Mead-Allen bill last Spring, James H. Perkins, Chairman of the Board of Directors of this Bank, stated that this institution alone was making loans to over 330,000 different borrowers. These included regular head office and branch loans (apart from loans to Stock Exchange brokers and dealers) amounting to $260,000,000, extended to over 6,000 customers, of whom 91 per cent were borrowing amounts of $50,000 or less. In the personal loan department, set up especially to serve the needs of the small borrowers, there were on the books about 325,000 loans, of which 30,000 were estimated to be to small business men.

One cause of misunderstanding on the part of the public lies in the fact that currently reported totals of outstanding bank loans, which frequently show little change, give an utterly inadequate picture of the turnover of loans that is constantly taking place in bank portfolios. For this reason the recently published report of a survey by the American Bankers Association of bank lending activity in New York State is of particular interest. According to this survey, based on replies to questionaires, commercial banks in this state during the first six months of 1939 made more than one million new loans totaling in excess of $4½ billions to business firms and individuals, and renewed more than a million outstanding loans amounting to more than $1½ billions. Certainly these figures demonstrate a willingness to lend when favorable opportunities are presented. In contrast with this showing of loans, the study revealed the interesting fact that business organizations are using only one-quarter of the "open lines of credit" kept constantly available to them on the books of the banks.

The Real Difficulty

With all that is being done already through public and private agencies to provide funds for small business, the usefulness of setting up new government machinery for further expansion in the lending business is surely open to question. From the evidence and testimony cited above there is clearly a cleavage of opinion, both in government and among business men, as to the need or wisdom of such expansion. Just how much further either the banks or government agencies can go in departing from accepted banking practices without inviting serious losses and encouraging irresponsible business competition is doubtful. Because of the risks involved in pushing lending too far it would seem preferable to seek aid for small business through elimination wherever possible of obstacles in the ordinary credit channels, such as for example the high cost of security registration, which perhaps could be lightened for the smaller business concerns.

After all, the real difficulty, as we see it, is not so much lack of credit, whether long or short, as it is lack of borrowers, and this reflects the reluctance of business men to undertake new enterprises or to expand the old. What is needed to overcome this is the creation of an atmosphere conducive to risk-taking,— in other words, emphasis upon general policies that will permit and encourage investment of private capital where the burden of risk-taking properly belongs.

Economic Resources of the Belligerents

In the mechanized and motorized warfare of today, even more than in 1914, the economic resources of the belligerents may become of decisive importance. The manufacture of modern instruments of war requires not only well developed engineering, automotive and chemical industries, with the necessary supply of skilled workers, but also an abundance of such common materials as iron ore and coal. Moreover, since 1914 a great number of industrial raw materials, including manganese, tungsten, magnesite, antimony, chromite, molybdenum and other minor metals, rubber, and above all petroleum, have become even more indispensable to modern warfare. The greater variety of the materials required in armaments, due to the technical progress to which all nations must conform, has in part neutralized the post-war efforts at self-sufficiency. For all these reasons the armies and weapons will be no stronger than the manufacturing facilities and the raw material supplies which support them.

The table accompanying this article assembles some of the statistical data which have a bearing upon the comparative economic strength of the warring countries. The figures come from various sources, too numerous to enumerate, and while complete accuracy cannot be claimed they are the most authoritative that we have been able to find. For a more complete appraisal, many factors not covered in the table would have to be considered. One is the extent to which stores of strategic raw materials and foodstuffs have been accumulated, and how far other preparations (development of substitutes, etc.) have been made to meet war requirements. Another is the ability of the belligerents to draw on foreign sources of raw materials and war equipment, which requires consideration of transportation facilities, effectiveness of the blockade, and means of payment. There is the question as to how far civilian needs will or may be curtailed, and how much peace-time production will or may be diverted into output of war equipment. For example, motorized armies will use vast quantities of oil and gasoline, but to what extent this expected increase in consumption will be counterbalanced by the restriction imposed on civil use of petroleum products can only be guessed at present.

Ample Raw Material Resources of the Allies

Nevertheless, even simple statistics have a story to tell of the weaknesses and the strong points in the belligerents' resources. Examination of the table will show that the Allied Powers will be able to cover most of their needs of basic raw materials from within their own boundaries. They may have large surpluses of iron ore, copper, rubber and also tin and nickel (the latter two not included in the table). The deficiency in crude oil is more apparent than real. Of the British and French controlled oil fields, those in Irak, Iran and Egypt could supply an additional 120,000,000 barrels of crude oil a year. The main deficiency is in certain lesser minerals, antimony, mercury and magnesite, most of which are needed only in small quantities. As regards foodstuffs and principal textile fibers, the Allied Powers are in an equally strong position—except in the case of cotton, where they must still rely on American sources.

Compared with 1914, the Allied Powers have greater raw materials resources at their command, and are much more self-sufficient. The stimulus given by the last war to the productive facilities of the Dominions and Colonies has placed them among the world's leading suppliers of minerals and foodstuffs. As the table on the following page giving the comparison with 1913 shows, the expansion of gold, rubber, copper, nickel, lead and zinc output has been phenomenal, particularly in Canada. By controlling nearly two-thirds of the world output of gold, the Allied Powers also have at their disposal a continuing means of payment.

Raw Material Production and Consumption of the British and French Empires, German Economic Territory and Danubian Basin

Output and consumption of industrial raw materials given in this table represent the highest annual figures reached in the period 1936-38. For agricultural products the figure is the average of the last three crops.

		Brit. Empire U. K.	Brit. Empire Other	French Empire	Total Allied Powers	Germany	Austria & Czech	Poland	German Eco. Terr.	Danube Basin*
Population (white) 000,000		47.4	24.9	42.0	114.3	68.6	20.4†	21.0‡	110.0	51.8
Coal (000,000 m.t.)	Output	245.1	77.7	49.0	371.8	186.2	17.2	38.1	241.5	2.1
Lignite (000,000 m.t.)	Output	......	3.5	......	3.5	195.0	21.2	......	216.2	17.6
Electricity (000,000 kwh.)	Output	30,700	39,600a	19,900	90,200	55,200	6,700	3,700	65,600	3,500
Crude Oil (000,000 bbl.)	Output	2.8	49.7	5.1	57.6	17.3	.5	4.0	21.8	64.5
" " "	Con.	92.8	112.6	62.5	267.9	53.0	2.2	3.4	58.6	17.8
Iron Ore (000,000 m.t)	Output	14.4	9.8	42.0	66.2	10.9	4.4	.9	16.2	1.2
" " "	Con.	17.0	6.0	16.0	39.0	33.0	3.7	1.3	38.0	1.1
Steel (000,000 m.t.)	Output	13.2	3.9	7.9	25.0	23.2	2.3	1.6	27.1	1.1
Copper (000 m.t.)	Output	......	613	1	614	33	1	......	34	42
" "	Con.	274	82	117	473	344	59	26	429	21
Lead (000 m.t.)	Output	31	591	47	669	89	11	6	106	89
" "	Con.	389	60	107	556	247	34	14	295	10
Zinc (000 m.t.)	Output	56	248	67	371	193	9	111	313	4
" "	Con.	232	53	92	377	261	27	51	339	3
Manganese Ore (000 m.t.)	Output	......	2,276	84	2,360	......	......	......	......	90
Rubber (000 m.t.)	Output	......	596	63	659	35	......	......	35	......
" "	Con.	115	75	60	250	98	21	8	127	7
Wool (000,000 lb.)	Output	105	1,560	99	1,764	38	3	12	53	136
" "	Con.	710	140	460	1,310	420	70	75	565	125
Cotton (000 bales)	Output	......	5,527	61	5,588	......	......	......	......	40
" "	Con.	2,650	3,200	1,200	7,050	1,075	575	295	1,945	350
Rayon Fibres (000,000 lb.)	Output	152	17	78	247	471	12	23	506	3
Wheat (000,000 bu.)	Output	62	906	380	1,348	191	76	79	346	420
" "	Con.	270	570	380	1,220	200	90	75	365	350
Rye (000,000 bu.)	Output	......	6	29	35	280	80	245	605	62
Sugar (000 m.t.)	Output	424	2,473b	1,158	4,055	2,307	706	556	3,569	340
" "	Con.	2,350	1,560b	1,440	5,350	2,000	410c	450	2,860	345

*Bulgaria, Hungary, Roumania and Yugoslavia. †Exclusive area ceded by Czecho-Slovakia to Hungary. ‡Est. population in the territory occupied by Germany. (a) Public stations only. (b) India excluded. (c) Czecho-Slovakia only.

Development of Natural Resources of the British Empire Countries, 1913-1938 (United Kingdom Excluded)

	All Dominions & Colonies 1913	All Dominions & Colonies 1936-38	Canada Alone 1913	Canada Alone 1936-38
Copper (000 t.)	94	613	34	266
Lead "	111	591	17	190
Zinc "	5	248	....	156
Aluminum "	6	64	6	64
Nickel "	24	105	23	102
Iron Ore (000,000 t.)	2.3	9.8	1.5a	1.7a
Steel "	1.20	3.89	1.10	1.43
Gold (000,000 oz.)	13.8	21.2	.7	4.7
Petroleum (000,000 bbls.)	9.1	49.7	.3	6.3
Rubber (000 t.)	47	596	....	....
Cotton (000 bales)	3,904	5,527	....	....
Sugar (000 t.)	953b	2,473b	11	66
Wheat (000,000 bu.)	643	906	217	327

a-Including Newfoundland. b-India excluded.

It will have to be borne in mind, of course, that the Allied resources are scattered all over the world, and will be available only as long as the navies keep the sea lanes open. The comparative nearness of Canada to Europe, along with her wide variety of natural resources and industrial diversification, makes her particularly suitable to serve as an industrial arsenal for the Allied Powers.

Germany Not Yet Self-Sufficient

The German Reich's only surpluses are in coal, zinc, potash and magnesite; in practically all other industrial raw materials she is deficient. However, by means of efficient organization of her economy, regulation of civilian needs, substitution and manufacture of synthetic materials, Greater Germany has been able to satisfy somewhat more than two-thirds of her raw materials requirements from within her own boundaries or those of the acquired territories of Austria, Czecho-Slovakia and Poland. In the output of food products, the Reich has improved her position somewhat as compared to 1914; she is believed to be able to produce adequate supplies of bread grains, sugar, potatoes, meats, and dairy products (the latter two with the help of foreign feedstuffs), but to be deficient in butter and animal fats, and vegetable oils. Nearly half of her fats and vegetable oils have normally been imported, mostly from overseas. If reports are true, the Reich will also be able to fall back upon large reserve supplies of certain raw materials (rubber, copper, gasoline) and the stored surpluses of grains from the excellent harvests of past years.

Most serious is the Reich's shortage of cotton, wool, rubber, tin, copper, petroleum products, iron ore, and of such tropical products as coffee and cocoa. For cotton and wool are being substituted rayon and staple fibre, of which Germany is now the second largest producer. Consumption of rubber in 1938 was nearly 100,000 tons, approximately one-third being supplied by the synthetic product called "buna" obtained from coal and lime. Some authorities believe the war may double German requirements of petroleum products, put at 53,000,000 barrels in 1938. The Reich's oil fields produced in 1938 less than 5,000,000 barrels, and the equivalent of some 14,000,000 barrels was obtained by the hydrogenation of coal.

Neutral Countries as Sources of German Supplies

The diversion of the entire surplus of Roumanian oil fields, amounting at best to about 50,000,000 barrels annually, would cover the Reich's peace-time oil needs, but on the above assumption would not suffice for war requirements. As will be noted from the large table, the countries of the Danubian Basin (Hungary, Roumania, Bulgaria, and Yugoslavia) could sell to the Reich foodstuffs and animal fats, rather than industrial raw materials. However, further expansion of trade between Germany and the neutrals may be handicapped either because of fear of ultimate economic domination or because of the problem of payments and transportation difficulties. Germany will have to rely upon the Baltic and upon overland transport; the latter, however, is inadequate to handle bulky raw materials from Russian and Roumanian sources.

Iron Ore Resources and Steel Output of the Belligerents
(000,000 Metric Tons)

	Iron Ore 1913	Iron Ore 1938	Steel 1913	Steel 1938
United Kingdom	16.0	12.1	7.8	10.6
Other Empire Countries:				
Newfoundland & Canada	1.5	1.7	1.1	1.2
India	.4	2.9	.1	1.0
Malaya	....	1.7	....	....
Australia	.2	2.3	....	1.2
Sierra Leone	....	.7	....	....
South Africa	....	.5	....	.3
Subtotal	2.1	9.8	1.2	3.7
French Empire:				
France	21.6*	33.1	4.6*	6.2
Algeria & Tunisia	1.9	4.0	....	....
Morocco	....	.3	....	....
Subtotal	23.5	37.4	4.6	6.2
Total Allied Powers	41.6	59.3	13.6	20.5
German Economic Empire:				
Old Reich & Saar	28.1*	10.9	18.6*	23.2†
Austria	2.0	1.8	.9	....
Czecho-Slovakia	1.8	2.6	1.2	1.8
Poland	.2	.9	....	1.5
Total German Empire	32.1	16.2	20.7	26.5

*Production within prewar frontiers. †Austria included.

German deficiency in iron ore resources is even more serious than in petroleum, because it cannot be made up readily by drawing upon the neighboring neutral territory. In 1938 German iron ore requirements were about 33,000,000 tons, of which nearly 9,000,000 was imported from Sweden and 2,500,000 from southeastern Europe (Yugoslavia) and Belgium. Some 10,000,000 tons came from France, Spain, North Africa and Newfoundland and will now be cut off or hampered by the blockade. In contrast to the present deficiency, Germany in 1914-18 controlled the vast Lorraine iron ore deposits, which are now on the French side of the Maginot line. She also controlled the Belgian steel industry; nevertheless, it became difficult to maintain the steel supply toward the end of the war.

The radical change in the German and Allied Powers' position in regard to iron ore and steel making facilities since 1913 is illustrated in the preceding table. German steel capacity since September, 1939, has been less than that indicated by the 1938 output, as many of the Saar blast furnaces, contributing about ten per cent of the total, have been forced to shut down. On the other hand, steel manufacturing capacity of the Allied Powers, and particularly France, is substantially greater than the actual 1938 output, given in the table, as 1938 was a relatively poor year. During the first six months of 1939 production was at an annual rate of 27,000,000 tons, or practically as much as the full capacity of the German economic area.

Strain on German Coal Resources

Germany has access to extensive resources of bituminous coal, to which must be added lignite (brown coal), the scientific exploitation of which was stimulated by the late war. Output of brown coal has exceeded that of bituminous in tonnage, but its heating quality is only about half as large. Forced by circumstances, German ingenuity has utilized coal and lignite not only as increasingly efficient sources of heat and power but also as raw materials for a vast number of by-products and synthetic production. These range from dyes to fertilizers and explosives, synthetic gasoline and plastics, — all of great importance to the gigantic endeavor of the Reich to become more self-sufficient. Coal is therefore more vital to the German economy than ever before. The Goering Works, which last month began operations for the smelting of low-grade iron ore deposits in Central Germany, is said to require more than twice the usual quantity of coke to produce one ton of iron. In the case of synthetic gasoline, the production of one ton is reported to require from 4.5 to 6 tons of lignite, and about ten times as many men as required in refining crude oil. It has been estimated that about 60 per cent of the total lignite production will have to be diverted into the output of synthetic petroleum products to meet German war needs.

With the German industries working at capacity, the strain on coal resources had become pronounced prior to the war, despite the decline in coal exports, enlargement of the mining force, longer working hours and greater mechanization. But for the acquisition of the rich coal deposits of Poland, Germany would soon have experienced an acute shortage. The conquest of Poland, however, may even make possible coal exports to the neighboring neutrals, in barter for food and other raw materials.

Curtailment of Civilian Consumption

It is as yet impossible to say to what extent the food and raw material requirements of the belligerents may change as a result of the curtailment of normal civilian consumption. Careful studies of German experience with raw material control during the late war show that reduction of civilian consumption can be carried to almost unbelievable lengths.

In 1914-18 the Germans curtailed drastically the use of cotton, wool, rubber and other materials entering into consumers' goods, and reduced the consumption of copper, tin, nickel, quicksilver and tungsten for non-military purposes by nine-tenths in many cases. Consumption of coal was drastically restricted, even at the cost of entirely shutting down certain manufacturing establishments. The effort extended even to the reclaiming of substantial amounts of metal by scrapping and melting up iron fences, copper roofs, hardware, old church bells and statuary.

It is already apparent that the belligerents are making a determined effort to avoid a rapid inflationary rise in prices such as occurred in the late war. The curtailment of consumers' purchasing power will be accomplished not only by direct and indirect rationing, but by control measures which range from the lowering of wages to taking away the major share of individual incomes above a certain level either by sharply graduated taxes, or, as has been recently proposed, by forced income contributions.

THIS IS OUR 25th YEAR IN LATIN AMERICA

THE National City Bank of New York was 102 Years old when it established its branch in Buenos Aires, thus becoming the first American national bank to enter the foreign field . . . That was on November 10, 1914—a quarter of a century ago.

Today there are forty-one National City branches in Latin America, each engaged in serving and developing American trade. They help to bridge the differences of race and language, and to interpret the banking laws, exchange and customs regulations. Through these twenty-five years of service in South America and Central America, National City has acquired an unrivaled knowledge of local conditions.

FIRST
in the Foreign Field

The Federal Reserve Act, passed December 23, 1913, provided that national banks might "Establish branches in foreign countries for the furtherance of foreign commerce of the United States, and to act, if required to do so, as fiscal agents of the United States".

Eleven months later (November 10, 1914), The National City Bank of New York became the first American national bank to enter the foreign field with the establishment of its branch in Buenos Aires.

If your business—like many others in America today—looks toward new opportunities on the Southern Continent, National City can be of service to you. You are invited to consult with executives at our Head Office or in any branch regarding your foreign trade problems.

THE NATIONAL CITY BANK OF NEW YORK

HEAD OFFICE: 55 WALL STREET **72 BRANCHES IN GREATER NEW YORK**

LATIN-AMERICAN BRANCHES

ARGENTINA
Buenos Aires
(*Sub-branches*)
Flores
Plaza Once
Rosario

BRAZIL
Rio de Janeiro
Pernambuco
Santos (Agy.)
Sao Paulo

CANAL ZONE
Balboa
Cristobal

CHILE
Santiago
Valparaiso

COLOMBIA
Bogota
Medellin

CUBA
Havana
(*Sub-branches*)
Cuatro Caminos
Galiano
La Lonja
Caibarien
Cardenas
Manzanillo
Matanzas
Santiago

DOMINICAN REPUBLIC
Ciudad Trujillo
Barahona
La Vega
Puerto Plata
San Pedro de Macoris
Santiago de los Caballeros

MEXICO
Mexico City

PERU
Lima

PUERTO RICO
San Juan
Arecibo
Bayamon
Caguas
Mayaguez
Ponce

REPUBLIC OF PANAMA
Panama
Colon

URUGUAY
Montevideo

VENEZUELA
Caracas

ESTABLISHED 1812

End

Member Federal Deposit Insurance Corporation

BRANCHES AFFILIATES AND CORRESPONDENT BANKS IN EVERY COMMERCIALLY IMPORTANT CITY OF THE WORL

Printed in U. S.

n
t
s.

K
ORK

c OF
a

r
video

LA
s

WORL

d in U.S.